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No. 92-1151

In the Supreme Court of the United States

OCTOBER TERM, 1992

UNSECURED CREDITORS' COMMITTEE OF C-T OF VIRGINIA, INCORPORATED, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the excise tax imposed under Section 4980 of the Internal Revenue Code, 26 U.S.C. 4980, is entitled to priority in distribution of a bankruptcy estate as an "excise tax" under Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A15) is reported at 977 F.2d 137. The opinion of the district court (Pet. App. A18-A26) is reported at 135 Bankr. 501. The memorandum opinion of the bankruptcy court (Pet. App. A29-A43) is reported at 128 Bankr. 628.

JURISDICTION

The judgment of the court of appeals was entered on October 2, 1992. The petition for a writ of certiorari was filed on December 31, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. C-T of Virginia, Inc., is a Virginia corporation engaged in the manufacture and wholesale and mail-order sale of shoes. In 1986, the company terminated a qualified pension plan and received a reversion of plan assets. The reversion resulted in the imposition of an excise tax under Section 4980 of the Internal Revenue Code which, in 1986, imposed an excise tax of 10% of the amount of assets that reverted to the employer. 26 U.S.C. 4980 (Supp. IV 1986). The excise tax thus assessed was $285,443.35 (Pet. App. A19).

After this assessment was made, C-T filed a petition for relief under Chapter 11 of the Bankruptcy Code. During the course of the bankruptcy proceeding, the Internal Revenue Service (IRS) filed an unsecured priority claim for the amount of the unpaid excise tax plus interest under Section 507(a)(7)(E) of the Bankruptcy Code, 11 U.S.C. 507(a)(7)(E). That Section establishes a priority for excise taxes on transactions that (i) occur before the date of the filing of the petition and for which a return was due within three years of the filing or (ii) occur within three years of the filing of the petition if no return is required. 11 U.S.C. 507(a)(7)(E). The Unsecured Creditors' Committee of C-T filed an objection to the government's priority claim, contending that the excise tax was a "penalty" that was not entitled to priority in distribution of the bankruptcy estate (Pet. App. A5-A6).

The bankruptcy court held that the IRS's claim was not entitled to priority (Pet. App. A43). The court held that the name given to an exaction under the Internal Revenue Code is not dispositive for bankruptcy purposes (Pet. App. A34). The court concluded that the legislative history of Section 4980 indicated that the excise tax under that Section was designed to discourage employers from terminating overfunded retirement plans and using

the excess funds for purposes other than employee benefits (Pet. App. A40). As a result, the court held that the exaction "is not a typical excise tax like those imposed on sales, gasoline, or estates and gifts which were clearly given priority by 11 U.S.C. § 507(a)(7)(E)" (Pet. App. A41).[1]

2. The district court reversed (Pet. App. A18-A26). The district court stated that it agreed that the congressional designation of the Section 4980 exaction as an "excise tax" is not dispositive of the priority issue under the Bankruptcy Code (Pet. App. A23). The court observed, however, that the Fourth Circuit had defined an excise tax for purposes of Section 507(a)(7)(E) of the Bankruptcy Code as a "pecuniary burden[] laid upon individuals or their property, regardless of their consent, for the purpose of defraying the expenses of government or of undertakings authorized by it" (Pet. App. A23) (quoting *New Neighborhoods, Inc.* v. *West Virginia Workers' Comp. Fund*, 886 F.2d 714, 718 (4th Cir. 1989)).[2] The court held that the Section 4980 exaction comports with this standard and is therefore properly classified as an "excise tax," rather than as a "penalty," for bankruptcy priority purposes (Pet. App. A26).

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[1] The bankruptcy court further held that the government's claim was not entitled to priority under 11 U.S.C. 507(a)(7)(G), which awards priority to claims for penalties that compensate for pecuniary losses (Pet. App. A41-A43). That issue was not addressed by either the district court or the court of appeals.

[2] This standard is derived from *City of New York* v. *Feiring*, 313 U.S. 283 (1941), a case under the former Bankruptcy Act. The issue in *Feiring* was whether a municipal sales tax was a "tax" entitled to priority under Section 64a(4) of the Bankruptcy Act or was a "debt" that was not entitled to priority. The *Feiring* case did not provide a definition of an "excise tax" for bankruptcy priority purposes. Indeed, the former Bankruptcy Act, unlike the current Bankruptcy Code, did not contain a provision expressly awarding priority to "excise taxes."

3. The court of appeals affirmed (Pet. App. A1-A15). The court stated that the priority question under the Bankruptcy Code is controlled by the purpose, and not the name, of the exaction (Pet. App. A10). The court held that the Section 4980 exaction "has substantially more of the attributes of an excise tax than of a punitive penalty" (Pet. App. A15) and is therefore entitled to priority under the Bankruptcy Code.

ARGUMENT

The court of appeals correctly held that the excise tax imposed by Section 4980 of the Internal Revenue Code is entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code. The decision of the court of appeals does not conflict with any decision of this Court or of any other court of appeals. Further review is therefore not warranted.

1. We do not agree with the analysis applied by the court of appeals in this case. Under the court's analysis, a federal excise tax will be entitled to priority in distribution of a bankruptcy estate only if the principal purpose of the exaction is revenue enhancement and not deterrence of socially undesirable conduct. But the Bankruptcy Code priority is for any "excise tax," *whatever* purpose Congress may have had in mind in enacting such a tax.[3] By the plain words of the statute, any federal "excise tax" is entitled to priority under Section 507(a)(7)(E) of the Bankruptcy Code. See *In re Mansfield Tire & Rubber Co. (United States* v. *Mansfield Tire & Rubber Co.*), 942 F.2d 1055 (6th Cir. 1991), cert. denied, 112 S. Ct. 1165 (1992). When Congress grants a bankruptcy priority for any "excise tax," and designates

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[3] Excise taxes generally discourage (or "penalize") to some extent the activity that is taxed. We have federal excise taxes on tobacco and liquor, not on bread and milk. That fact does not make excise taxes "penalties."

a particular exaction as an "excise tax," it is not the courts' function to disregard the precise words that Congress has employed. Our disagreement with the reasoning of the court of appeals, however, is of no consequence in this case, for the court correctly held that the excise tax under Section 4980 of the Internal Revenue Code is entitled to priority under the test the court chose to apply.

Congress enacted Section 4980 of the Internal Revenue Code as part of the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1132(a), 100 Stat. 2478. As enacted, the provision imposed a nondeductible 10% excise tax based on the value of assets in a qualified pension plan that reverted to an employer upon termination of the plan. 26 U.S.C. 4980(a) (Supp. IV 1986).[4] The Committee Reports explained the provision as follows:

> The committee believes that it is appropriate to limit the tax incentives available for retirement savings provided through defined benefit pension plans to the amount actually applied to provide retirement income. To the extent that amounts in such plans are not used for retirement purposes and revert to an employer, the committee believes that the tax treatment of reversions should recognize that the tax on earnings on pension funds is deferred and, thus, the benefits of this tax treatment should be recaptured. Although the committee believes that it might be possible to determine the particular year or years in

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[4] The excise tax was increased to 15% in 1988 (Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, § 6069(a), 102 Stat. 3704) and to 20% in 1990 (Omnibus Budget Reconciliation Act, Pub. L. No. 101-508, § 12001, 104 Stat. 1388-562). The 1990 amendment also provided that the excise tax would be imposed at a 50% rate unless the employer established or maintained a qualified replacement plan. Omnibus Budget Reconciliation Act, § 12002(a), 104 Stat. 1388-562.

> which contributions resulting in a reversion arose and to recoup the resulting tax benefit attributable to a reversion on that basis, the committee is concerned that such a computation would involve undue complexity. Under the circumstances, therefore, the committee determined that a nondeductible excise tax should be imposed on reversions at a uniform rate.

S. Rep. No. 313, 99th Cong., 2d Sess. 636 (1986); H.R. Rep. No. 426, 99th Cong., 1st Sess. 756 (1985).

As these reports indicate, the principal purpose of the Section 4980 excise tax was to recoup the tax benefits obtained during the existence of a qualified pension plan upon termination of the plan. The exaction imposed against C-T under Section 4980 was designed to recover tax benefits that the government had allowed while the company's pension plan was in existence. The legislative history does not support petitioner's contention (Pet. 27) that Congress's primary purpose in enacting Section 4980 was to punish employers who engaged in socially undesirable conduct.[5]

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[5] Petitioner's reliance (Pet. 23-27) on the legislative history accompanying the enactment of *subsequent* versions of Section 4980 in attempting to establish the purpose of Congress in enacting the 1986 version of the statute is inappropriate. Cf. *Pierce* v. *Underwood*, 487 U.S. 552, 566-567 (1988). The fact that the Treasury Report to the President (Pet. 22-24), which was issued two years prior to the enactment of Section 4980, indicated that the provision would have the salutary *effect* of deterring abuses of qualified pension plans, does not establish that deterrence was the *primary purpose* of the provision. As this Court has emphasized, "the authoritative source for finding the Legislature's intent lies in the Committee Reports on the bill" (*Garcia* v. *United States*, 469 U.S. 70, 76 (1984)). As discussed in the text, those reports do not support petitioner's contention that the primary purpose of the 1986 version of Section 4980 was to punish socially undesirable conduct.

2. The decision of the court of appeals does not conflict with *In re Kline (United States v. Feinblatt)*, 403 F. Supp. 974 (D. Md. 1975), aff'd, 547 F.2d 823 (4th Cir. 1977), and *In re Unified Control Systems, Inc. (Mahon* v. *United States Internal Revenue Serv.)*, 586 F.2d 1036 (5th Cir. 1978), as petitioner contends (Pet. 31-32). *Kline* and *Unified Control* involved the excise taxes imposed upon prohibited activities involving private foundations. The issue before the courts of appeals in those cases was whether the government's claim was entitled to fourth priority in distribution as a "tax" under Section 64a of the former Bankruptcy Act or was to be disallowed in its entirety as a "penalty" under Section 57j of that Act. The courts applied the same test adopted by the Fourth Circuit in this case in concluding that the exactions were "penalties." See 403 F. Supp. at 978-979 (noting that the "sole substantial purpose" of the excise taxes imposed by Sections 4941 and 4944 of the Internal Revenue Code was to penalize wrongful conduct); 586 F.2d at 1039 (concluding that the excise taxes imposed by Sections 4941(a)(1) and 4941(b)(2) "were intended to curb the described conduct through pecuniary punishment"). The decisions in *Kline* and *Unified Control* do not conflict with the decision in this case because those cases involved different tax provisions and different priority provisions from those at issue in the present case—provisions to which the courts in those cases applied the same legal standard on which the courts below relied in this case.

3. The decision in this case also does not conflict with the Tenth Circuit's recent decision in *In re Cassidy (United States* v. *Dumler)*, 983 F.2d 161 (1992). The issue in *Cassidy* was whether the additional income tax imposed by Section 72(t) of the Internal Revenue Code against individuals who receive an early distribution from a qualified retirement plan is entitled to priority as

"a tax on or measured by income" under Section 507(a)(7)(A) of the Bankruptcy Code. The Tenth Circuit, applying the same test applied by the Fourth Circuit in this case, concluded that the history of the Section 72(t) exaction reflected that it was primarily designed to punish socially undesirable conduct and was thus a "penalty" rather than a "tax." By contrast, the legislative history of Section 4980 reflects that the exaction under that Section was primarily designed to recapture tax benefits associated with the existence of a qualified pension plan. See pp. 5-6, *supra*. The decision in *Cassidy* is thus inapposite to this case.

4. The fact that different rationales were employed in this case and in *In re Mansfield Tire & Rubber Co.*, *supra*, does not provide a basis for further review. Under the reasoning of the Sixth Circuit in *Mansfield Tire*, an "excise tax" is entitled to priority because Congress has enacted it as an "excise tax." Under the reasoning of the Fourth Circuit in this case, the excise tax under Section 4980 is entitled to priority because it was not primarily designed to punish socially undesirable conduct. The result is the same under either approach.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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